

Message Text

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DEPARTMENT PASS TREASURY, FRB AND CEA

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: ECONOMIC SITUATION AS VIEWED BY SENIOR FRG

OFFICIAL: HOW DURABLE THE UPTURN?

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REF: BONN 4114 (NOTAL)

SUMMARY: A TOP ECONOMIC POLICY OFFICIAL GAVE US A VIEW OF THE IMMEDIATE ECONOMIC PICTURE THAT COULD BEST BE DESCRIBED AS MUTED OPTIMISM WITH MUTED PESSIMISM BEING THE OUTLOOK FURTHER BEYOND - PERHAPS BEGINNING IN THE SECOND HALF OF 1976 AND EXTENDING INTO THE MEDIUM TERM. HOUSING, WAGE SETTLEMENTS AND PRIVATE CONSUMPTION CURRENTLY ARE ENCOURAGING. UNCERTAINTY STEMS FROM POTENTIAL PROTECTIONIST MEASURES WITHIN THE EC THROTTLING GERMAN EXPORTS AND A WEARING OFF OF THE TEMPORARY EFFECTS OF STOCKBUILDING AND THE INVESTMENT BONUS SCHEME. CONTINGENCY STIMULATION MEASURES ARE BEING CONSIDERED, ALTHOUGH RELUCTANTLY AND IN DEEPEST SECRECY. THE UNEMPLOYMENT PROBLEM IS GOING TO PERSIST INTO THE MEDIUM-TERM WITH ONLY PALLIATIVE MEASURES LIKELY. THE GOVERNMENT'S PUBLIC FORECAST PRODUCTIVITY ASSUMPTIONS ARE FAULTY AND LEAD TO AN UNDERSTATEMENT OF THE SEVERITY OF THE PROBLEM. ECONOMIC POLICY WILL NOT BE A MAJOR CAMPAIGN ISSUE - RADICALISM WILL. END SUMMARY

1. IN A WIDE RANGING CONVERSATION WITH THE EMBASSY ECONOMIC/COMMERCIAL MINISTER, DR. HANS TIETMEYER, THE ASSISTANT SECRETARY (MINISTERIAL DIREKTOR) RESPONSIBLE FOR ECONOMIC POLICY IN THE ECONOMICS MINISTRY, PROJECTED A SUBDUE IF NOT SOMBER VIEW OF THINGS. HE SAID HE SAW TWO DANGERS FOR THE FUTURE CONTRIBUTING TO THE UNCERTAINTY OF THE DURATION OF THE UPTURN. THE FIRST HE MENTIONED WAS THE TENDENCY TOWARD PROTECTIONISM WITHIN THE EEC (FAR WORSE IN POTENTIAL REPERCUSSIONS THAN THE SIMILAR PHENOMENON IN THE U.S.). HE SAID HE SAW SUBSTANTIAL POSSIBILITIES FOR THE ERECTION OF TRADE BARRIERS TO INTERFERE WITH THE FREE MOVEMENT OF GOODS BETWEEN MEMBERS OF THE COMMUNITY STEMMING FROM DOMESTIC PRESSURES THAT MIGHT OVERWHELM THE LEADERSHIP IN SUCH PLACES AS ITALY, FRANCE AND THE U.K. THIS COULD HAVE HEAVY CONSEQUENCES FOR GERMANY, GREATLY DEPENDENT AS IT IS ON EXPORT GROWTH FOR ITS ECONOMIC WELL BEING. THE SECOND DANGER FOR THE UPTURN THAT HE FORESAW WAS ON THE INTERNAL GERMAN SIDE. WHILE STOCKBUILDING WILL PROVIDE A STRONG IMPULSE FOR GROWTH IN THE FIRST PART OF 1976,

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HE SAW THIS AS ONLY A TEMPORARY PHENOMENON. FURTHERMORE, HE CONSIDERS THE SURGE IN INVESTMENT AN ARTIFICIAL CREATION RESPONDING TO THE GOVERNMENT'S INVESTMENT BONUS PROGRAM WHICH WILL SOON CEASE TO HAVE ANY SIGNIFICANT EFFECT. HE TOOK SOME HEART, HOWEVER, FROM A RESURGENCE IN THE DEMAND FOR HOUSING. HE CONSIDERED CONSUMER DEMAND TO BE AT A SATISFACTORY LEVEL. THE BIG QUESTION, HOWEVER, IS WHETHER THE OTHER DEMAND ELEMENTS WILL BE

STRONG ENOUGH FOR A SELF-SUSTAINING UPTURN WITHOUT THERE
BEING ADDITIONAL ARTIFICIAL STIMULATION.

2. THE RESERVED NATURE OF TIETMEYER'S OUTLOOK CONTRASTS
WITH THE MORE ENTHUSIASTIC READINGS BEING NOTED ELSE-
WHERE WHICH HAVE BEEN UNDOUBTEDLY INFLUENCED BY THE VERY
FAVORABLE NEW ORDERS DATA JUST RELEASED. ANALYZING THE
QUITE POSITIVE DATA FOR JANUARY, TIETMEYER WAS CAUTIOUS
IN SAYING THAT TOO MUCH EMPHASIS SHOULD NOT BE PLACED ON
ONLY ONE MONTH'S FIGURES. THIS WAS ESPECIALLY TRUE IN
THE CASE OF THIS PARTICULAR SERIES WHICH HAS A RATHER
ERRATIC NATURE. HE CHARACTERIZED THE PICTURE AS NOT
BEING THAT CLEAR YET.

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3. IN VIEW OF HIS RESERVATIONS CONCERNING THE FUTURE DEVELOPMENTS WE ASKED TIETMEYER WHETHER THE GOVERNMENT HAD SOME CONTINGENCY PLANS FOR POSSIBLE STIMULATION IN THE EVENT THE RECOVERY STALLED. HE RESPONDED THAT OF
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COURSE WITHIN HIS MINISTRY SUCH MATTERS WERE BEING EXAMINED. HOWEVER, HE WARNED THAT THIS IS A MATTER OF UTMOST SECRECY AND THAT IT MUST BE TREATED ON A "FOUR EYES" BASIS. THE PROBLEM IS, HE SAID, THAT GENERAL KNOWLEDGE OF THE CONSIDERATION OF SUCH CONTINGENCIES WOULD HAVE A NEGATIVE EFFECT INSOFAR AS THE SELF-FULFILLING PROPHECY REPERCUSSIONS. (THIS THEME REITERATES WHAT WE HEARD AND REPORTED OF "WISE MAN" PROFESSOR GUTOWSKY'S VIEWS ON THE SUBJECT.)

4. TIETMEYER STRESSED THE IMPORTANCE OF MODERATE WAGE INCREASES TO THE SUSTAINABILITY OF THE GERMAN UPTURN. HE THOUGHT THAT THE 5.4 PERCENT SETTLEMENT JUST REACHED IN THE METAL INDUSTRY IN THE NORTH WUERTTEMBERG/NORTH BADEN REGION BODED WELL ON THIS FRONT. HE ESTIMATED THAT THE PUBLIC SECTOR EMPLOYEES WILL BE HELD TO A 4 PERCENT INCREASE AND THAT THE OVERALL WAGE RISE WILL, ON THE AVERAGE, RANGE FROM 5 TO 5.5 PERCENT. IT WAS HIS JUDGMENT THAT THE WAGE RATIO OF NATIONAL INCOME WAS MUCH TOO HIGH AND HE averred THAT THIS WAS OF COURSE A POLITICAL ISSUE OF CONSIDERABLE SENSITIVITY.

5. TURNING TO THE MEDIUM TERM, TIETMEYER SAID THAT THE FRG MUST HAVE STRONG GROWTH FOR SEVERAL YEARS. IN ORDER TO ACHIEVE THIS IT IS NECESSARY THAT THE SAVINGS RATIO MUST BE LOWERED AND MAINTAINED AT NO HIGHER THAN 14 PERCENT SO THAT PRIVATE CONSUMPTION GROWTH MIGHT PROVIDE SUFFICIENT DOMESTIC DEMAND IMPULSES. FURTHER, HE SAID, BUDGET AND TAX POLICY MUST STABILIZE IN ORDER TO INSTILL CONFIDENCE. THIS, RATHER A DEMAND STIMULATION WAS MOST IMPORTANT. THE GOVERNMENT CAN DO ALL THAT IT WANTS BY WAY OF EXPANDING GOVERNMENT EXPENDITURES BUT IF THERE IS NO CONFIDENCE, THE NET RESULTS WILL BE NEGATIVE.

TIETMEYER SAID THAT IN THE SHORT TERM, STIMULATIVE MEASURES MIGHT HAVE A TEMPORARY POSITIVE PATINA, BUT FOR THE LONGER TERM THE NET RESULTS COULD ONLY END UP LESS THAN DESIRABLE.

6. TURNING TO THE UNEMPLOYMENT PROBLEM, TIETMEYER WAS ENCOURAGED BY THE DOWNWARD TREND IN THE NUMBER OF SHORT-TIME WORKERS. HE JUDGED THAT THE AVERAGE UNEMPLOYMENT

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RATE IN 1976 WOULD POSSIBLY REPEAT POSSIBLY BE 4.5 PERCENT (THE OFFICIALLY PUBLISHED FORECAST) AND THAT THE SEASONAL LOW POINT JUST BEFORE THE OCTOBER ELECTIONS WOULD SEE THE NUMBER OF UNEMPLOYED IN NONADJUSTED TERMS AT AROUND 900,000 FROM WHICH POINT, OF COURSE, IT WOULD RISE UNTIL THE END OF THE YEAR.

7. WE ASKED TIETMEYER WHETHER HE AGREED WITH THE GOVERNMENT AND HIS MINISTRY'S FORECAST THAT PRODUCTIVITY INCREASES IN 1976 WOULD AVERAGE 4.5 PERCENT OR THE SAME AS REAL GNP GROWTH. (N.B. HIS PEOPLE PRODUCED THE ANNUAL ECONOMIC REPORT CONTAINING THE FORECAST.) HE RESPONDED THAT HE PERSONALLY FELT THIS WAS UNREALISTIC AND THAT RATHER THE PRODUCTIVITY INCREASE COULD BE 1 TO 1.5 PERCENTAGE POINTS ABOVE THE GNP GROWTH RATE. WHEN WE OBSERVED THAT THIS WOULD INVOLVE A FURTHER DECREASE IN EMPLOYMENT BEYOND THE 300,000 CUTBACK THE GOVERNMENT PROJECTS, HE AGREED. HE ALSO AGREED WITH THE OBSERVATION THAT THIS WOULD SIGNIFY A 250,000 TO 400,000 ADDITIONAL REDUCTION IN EMPLOYMENT IN 1976 TO THE 300,000 ASSUMPTION. WHEN ASKED WHETHER THIS AMOUNT WOULD IMPACT BY A LIKE MARGIN ON THE UNEMPLOYED RATE, HE SAID NOT NECESSARILY SO, MENTIONING FOREIGN WORKER OUTFLOWS AND AN INCREASE IN UNREGISTERED UNEMPLOYED AS POSSIBLE MODERATING ALTERNATIVES. HE DID AGREE, HOWEVER, THAT THE TOTAL 400,000 OR SO ALREADY INCORPORATED IN THE GOVERNMENT FORECASTS FOR SUCH CATEGORIES (THAT TEND TO REDUCE THE REGISTERED UNEMPLOYED NUMBER) WERE VERY HIGH ALREADY AND LEFT LITTLE ROOM FOR HOPE THAT THEY COULD BE EXPANDED FURTHER TO TAKE UP THE SLACK IMPLIED BY THE FAULTY PRODUCTIVITY ASSUMPTION.

8. TIETMEYER SAID THAT THE UNEMPLOYMENT PROBLEM WOULD BE A PERSISTENT ONE AND THAT 1977 WOULD ALSO BE A DIFFICULT YEAR IN THIS REGARD. EVEN IF GROWTH IN 1977 WAS IN THE 4 - 5 PERCENT RANGE EXPECTED FOR 1976, THERE WOULD BE NO IMPROVEMENT WHATSOEVER ON THE LABOR MARKET. EMPLOYERS UNDERSTANDABLY ARE LOATHE TO HIRE ADDITIONAL

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HARD-TO-FIRE EMPLOYEES AND WOULD RATHER INCREASE THE
WORKING TIME OF EXISTING STAFF AS PRODUCTION INCREASES.
HE THOUGHT THAT REGIONAL JOB CREATION PLANS AND TRAINING
PROGRAMS INVOLVING THE STATE AND LOCAL GOVERNMENTS (NOT
THE FEDERATION) WERE MEASURES THAT MUST BE UTILIZED TO
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ATTACK THE EMPLOYMENT PROBLEM. IN THIS WAY FEDERAL EXPENDITURE LEVELS WOULD NOT HAVE TO BE UNDULY INCREASED AND THE DEBT LIMITATION STRICTURES OF ARTICLE 115 OF THE BASIC LAW WOULD BE AVOIDED. HE WAS MOST PESSIMISTIC, HOWEVER, ON EFFORTS TO REDUCE UNEMPLOYMENT. IN FACT HE SAID THAT IT WAS "IMPOSSIBLE TO IMPROVE THE SITUATION" EVEN IN THE MEDIUM TERM.

9. THE UNEMPLOYED YOUTH PROBLEM IS SERIOUS, TIETMEYER OBSERVED. IN THIS THERE WAS PARTICULARLY A GREAT POLITICAL RISK IN THAT THERE WAS BEING CREATED IN GERMANY A KIND OF ACADEMIC PROLETARIAT. HIGHLY EDUCATED INDIVIDUALS WERE BEING POURED ON THE LABOR MARKET AND WOULD CONTINUE TO BE SO IN EVER-INCREASING NUMBERS WITHOUT THE POSSIBILITY THAT THEY WOULD BE ABLE TO FIND JOBS THEY CONSIDERED SUITABLE. THE TRADITIONAL PRESERVE FOR LARGE NUMBER OF THE LAWYERS AND PROFESSIONALS, THE PUBLIC SECTOR, WOULD NO LONGER BE ABLE TO ABSORB THEM, HE SAID. HE CONTINUED THAT THEY WILL ALSO LIKELY FIND IT LESS AND LESS POSSIBLE TO FIND A PLACE IN THE PRIVATE ECONOMY.

10. AFTER AN EXTENDED PERIOD OF EXPANSION, THE PUBLIC SECTOR'S GROWTH WILL NOW HAVE TO ENTER A "CONSOLIDATION" PHASE HE SAID. IN THIS CONNECTION HE SAW REFORMS TAKING PLACE AFTER THE ELECTION WHICH WOULD SERVE TO HALT THE GROWTH IN HEALTH AND RETIREMENT BENEFITS. (THIS IS A THEME HEARD ELSEWHERE, EVEN IN SOME SPD, ALBEIT FINANCE MINISTRY, CIRCLES.)

11. TIETMEYER THOUGHT THAT INSOFAR AS THE ELECTION IS CONCERNED, ECONOMIC POLICY WOULD NOT BE THE MAJOR CAMPAIGN ISSUE. ON THE OTHER HAND, HE OPINED THAT THE RADICAL QUESTION (PRESUMABLY TERRORISM, THE HIRING OF RADICALS FOR THE CIVIL SERVICE, AND A GENERAL LEFTWARD DRIFT IN THE APPROACH TO GOVERNMENT) WOULD BE THE PRINCIPAL ISSUE. EVEN SO, ECONOMIC POLICY WOULD NOT BE COMPLETELY ABSENT. WHEN IT ENTERED INTO CAMPAIGN RHETORIC, IT WOULD BE IN RELATION TO GENERAL PHILOSOPHY (NATIONAL PLANNING, INCOME DISTRIBUTION, ETC.) AND LONGER TERM DEVELOPMENTS, NOT THE ACTUAL FIGURES AND THE

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CURRENT ECONOMIC SITUATION. THE LATTER, HE THOUGHT, FAVORED THE COALITION SOMEWHAT, BUT NOT SO MUCH.

12. COMMENT. DR. TIETMEYER, ALTHOUGH ONE OF FDP
MINISTER FRIDERICH'S PRINCIPAL POLICY FORMULATORS IN THE
ECONOMICS MINISTRY, IS NONETHELESS A KNOWN CDU
MEMBER. THEREFORE, THE VIRTUAL IDENTITY OF ECONOMIC
POLICY VIEWS ALSO NOTED ELSEWHERE ON THE PARTY LEVEL IS
PROBABLY NOT SURPRISING. THE RELATIVELY PESSIMISTIC
VIEW ON THE PERSISTENCY OF THE UNEMPLOYMENT PROBLEM AND
THE WARINESS ON THE OUTLOOK DID NOT, HOWEVER, SEEM TO
HAVE BEEN OVERDONE FOR OUR BENEFIT. WE JUDGE IT AN
OBJECTIVE AND REALISTIC APPRAISAL OF A MAN WHO SHOULD
KNOW AS WELL AS ANYONE THE GENERAL SHAPE OF THE FUTURE.
IT ALSO HAPPENS TO ACCORD IN TONE WITH THE VIEWS
OF CHANCELLOR SCHMIDT REPORTED BY US LAST WEEK. END
COMMENT.
HILLENBRAND

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